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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966.

No. 1391.

IN THE MATTER OF:

LENRICK SALES, INC., BANKRUPT

AARON COHEN, TRUSTEE,

Petitioner,

v.

JAMES TALCOTT, INC., SHAPIRO BROS. FACTORS CORP.; CROMPTON-RICHMOND CO., INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENTS IN OPPOSITION.

OPINIONS OF THE COURT BELOW.

The opinion of the Court of Appeals for the Third Circuit (App. of Petition, p. 39) is reported as 369 F. 2d 439 in appendix to advance report 373 F. 2d, No. 3. The opinion of the District Court (App. of Petition, p. 36) does not appear in the official reports.

JURISDICTION.

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED.

Whether a referee in bankruptcy failed to abide by the Bankruptcy Act and denied the major creditors substantial rights and procedural due process where he refused to hold a hearing on objections to the claims of creditors entitled to vote and failed to hold an election of a Trustee before appointing a Trustee of his own choosing, and where he received letters not offered in evidence as proof of the disqualification to vote of the claims of the majority of the creditors.

STATEMENT OF THE CASE.

The petitioner, Aaron Cohen, is the trustee in bankruptcy appointed in these proceedings by order of the Referee entered March 21, 1966 (App. of Petition, p. 19).

The respondents are three unsecured general creditors [1] with claims presented at the first meeting of creditors aggregating $44,126. The total of all such claims was approximately $118,000.

On January 10, 1966, the bankrupt, a close corporation retailing wearing apparel, filed an original petition for an arrangement under Chapter XI of the Bankruptcy Act. The Judge permitted the then debtor to remain in possession and referred the proceedings to the Referee, who did not, as Section 334 of the Bankruptcy Act (11 U. S. C. 734)

1. Petitioner mistakenly states that respondents are factors of the bankrupt (Petition, p. 9). Respondents are factors and assignees of the bankrupt's suppliers.

requires, hold a first meeting of creditors in Chapter XI within 40 days of the filing of the petition, or thereafter. On February 23, 1966, at the bankrupt's application, the court entered an adjudication in bankruptcy and appointed as receiver, Aaron Cohen, Esquire, whose appointment as trustee the Court of Appeals vacated.

On March 21, 1966, the Referee held the first meeting of creditors in bankruptcy. No stenographic record was made of the proceedings. The opinion of the Court of Appeals describes the record of this hearing as follows (App. of Petition, p. 40):

> "The Referee's contemporaneous notes of the meeting are so scanty as to be substantially useless. A predictable controversy ensued as to what there occurred. However, we confine ourselves to the record and the reasonable inferences therefrom.
>
> "We do know from the Referee's notes that the bankrupt was examined. We think it fair to infer that representatives of a majority of creditors in both number and amount were present and attempted to vote for their own nominee. However, by an order dated March 21, 1966, the referee appointed Cohen as Trustee. The printed portion of the caption of the order reading 'Order Approving Appointment of Trustee' is stricken. The words 'Appointment of Trustee by Referee' remain. Moreover, the order contains a recital that 'The Creditors * * * failed to appoint a trustee".

On March 31, 1966, respondents filed with the Referee their petition for review of the order of March 21.[2] On

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2. Petitioner incorrectly states that the petition for review referred primarily to the refusal of the Referee to appoint a creditors committee (Petition, p. 10). The petition for review challenges directly and clearly the Referee's appointment of petitioner as trustee (App. of Petition, pp. 22, 23).

April 14, the Referee made findings of fact and conclusions of law and filed a memorandum opinion. Contrary to his order of March 21, the Referee stated in his certificate (App. of Petition, p. 30), that 65 claims aggregating $113,738.99 were voted in favor of the nominee of creditors, opposed to the petitioner herein; and he expressly found that Harry Levy, Esquire, had voted two claims totaling $3,714 in favor of the challenged trustee, and that the attorney for the bankrupt had done likewise with one claim for $865.55. The latter paper was on its face for an administration expense, a bill in proof form for accounting services rendered in the Chapter XI proceedings.

The Referee ex post facto found twenty-eight proofs then on file had been allowed. This finding therefore included the three claims voted for Cohen and necessarily, too, the proof of respondent, Shapiro Bros. Factors Corp., docketed as Claim No. 4.

But up to August 26, 1966, nothing in the files of this case, including the Referee's docket or his official claim register, indicated the allowance or disallowance of any proof.

The Referee's rationale for not honoring the 65 claims, including the respondents', was (1) they had been solicited by a Creditors' Committee; (2) two letters which were turned over to him (when, how and by whom being unstated) limited the power of attorney in the proofs thus solicited to voting for a tentative trustee at the first meeting under Chapter XI which the Referee had failed to call. But one of the letters simply gave notice of the change of locale of the creditors' meeting; (3) the sixty-five claims were not filed prior to the meeting or allowed; (4) the estate was practically liquidated and the appointment of a Creditors' Committee and a trustee other than the incumbent receiver, would result in additional expense; and (5) the Creditors' Committee by not accepting what the debtor offered in settlement had foolishly or improperly caused the bankruptcy.

The District Court Judge adopted the referee's report of April 14th and sustained him on two grounds: first, that the powers of attorney in the proofs obtained by the committee were limited to the election of a tentative trustee in the Chapter XI proceedings. Like the referee, the judge assumed that four powers running to George A. Hahn, Esquire, were also solicited and obtained by the committee and that therefore those powers were also limited.

The second ground was that the referee had named the trustee because creditors had disagreed. This ground rejected the referee's many express statements to the contrary; namely, that Cohen's three proofs for $4,580.05 were a majority in number and amount and Hahn's four proofs for $51,182, plus the sixty-one further proofs amounting to $62,000 more, having been disallowed, were not a majority in number and amount.

The Court of Appeals reversed the order of the District Court and remanded the proceeding for the entry of an order directing the Referee to vacate the Trustee's appointment and to promptly notice a new meeting of creditors to elect a trustee.

ARGUMENT.

I. Petitioner Has No Standing to Appeal.

Petitioner was appointed trustee in bankruptcy by the Referee. His appointment was declared to be invalid by the Court of Appeals, and the District Court was directed to vacate it and to see to it that another meeting is called by the Referee to permit creditors to elect a trustee.

Petitioner is not a party in interest. He is not a creditor. He is not "aggrieved" by the order of the Court of Appeals directing that his appointment be vacated. See Section 39(c) of Bankruptcy Act, 11 U. S. C. § 67. No person has a right to be trustee, and no one has a vested interest in the office. Only creditors who sought or sponsored his election or appointment have an appealable interest. *Matter of Grossman*, 225 Fed. 1020 (D. C. N. Y., 1915).

In *General Motors Truck Co. of Louisiana, Inc. v. Caddo Transfer & Warehouse Co., Inc.*, 176 La. 181, 145 So. 372 (1932), it was held that a receiver has no right to appeal from an order removing him from office. Quoting from *Clark, the Law of Receivers*, Sec. 680, p. 743, the Court stated:

> "A receiver has no property right in the office of receiver. He holds such office by sufferance of the court appointing him. He, therefore, has no substantial right violated by being removed from office and, therefore, has no right to appeal from such order."

A trustee in bankruptcy appointed by the court has the same relationship to his office as a receiver.

It is respectfully submitted that petitioner herein has no standing to question the order of the Court of Appeals removing him, and he is therefore not a proper party to petition for certiorari.

II. There Is No Conflict of Decisions.

Petitioner asserts that the controlling question is the degree of authority vested in a court of bankruptcy over the selection of a trustee. Petitioner contends that there is a "disparity" among the courts of appeal on this question, and that it has not been precisely settled by this Court.

Respondents find no disagreement whatever among the federal courts on this issue.

The order of the Referee under review appointed a trustee in bankruptcy on the ground that creditors failed to elect one. Section 44(a) of the Bankruptcy Act, 11 U. S. C. § 72 provides:

> "The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate. *If the creditors do not appoint a trustee or if the trustee so appointed fails to qualify as herein provided, the court shall make the appointment.*" (Italics added.)

The Court of Appeals held (App. of Petition, p. 45):

> "We think the record does not legally or factually justify the preemptory action of the Referee in appointing the Trustee and thereby depriving the 'majority' creditors of a reasonable opportunity to select the Trustee. In fact, such record as we have comes close to compelling the conclusion that the votes in question should have been counted. In any event, we think the record shows that only another meeting of creditors, properly conducted and recorded, can ade-

quately correct the unfortunate series of errors in these proceedings."

Although courts of bankruptcy have supervisory power over the election of a trustee, and appellate courts, in reviewing the exercise of such power, are subject to the "clearly erroneous" rule, arbitrary action on the part of a Referee may always be shown and reversed on appeal. The law and cases on this subject are extensively discussed in *2 Collier on Bankruptcy,* Par. 44.02, p. 1637, et seq. The federal decisions are not in conflict with respect to the above principles. They are in agreement that the "choice of the creditors is not lightly to be disregarded." *In the Matter of Eloise Curtis, Inc.,* 326 F. 2d 698, 700 (CCA 2d, 1964); *In re Bay Parkway Haberdashers and Hatters, Inc.,* 69 F. 2d 103 (CCA 2d, 1934); *In re Mayflower Hat Co.,* 65 F. 2d 330 (CCA 2d, 1933).

Petitioner has cited no case in conflict with the above stated law. *Kimm, et al. v. Cox, et al.,* 130 F. 2d 721 (CCA 8th, 1942) merely applies the "clearly erroneous" rule to a case involving conflicting evidence. *Schwartz v. Mills,* 192 F. 2d 727 (CCA 2d, 1951) deals primarily with the eligibility of a creditor who is also one of the principal stockholders to vote in the election of a trustee. *In re John F. McGill,* 106 F. 2d 57 (CCA 6th, 1901), held that proxies given by creditors to the bankrupt's attorney were invalid as the bankrupt would not be permitted to control the election.

Nor has petitioner demonstrated that the Court of Appeals incorrectly applied the law to the circumstances of this case. In order to sustain his appointment of a trustee, the Referee was required to show that creditors had failed to elect. On the contrary, he found as a fact that claims, constituting in fact a majority of all creditors in number and amount, were voted for the nominee whom he disregarded (App. of Petition, p. 30). He also found that such claims were not filed or allowed at the meeting. But Section 55(b) of the Bankruptcy Act, 11 U. S. C. 91,

makes it clear that the first meeting is the time for the presentation and allowance of claims, at least for voting purposes: *2 Collier on Bankruptcy,* 14th ed., p. 1641. It provides:

> "At the first meeting of creditors, the judge or referee . . . before proceeding with other business, may allow or disallow claims of creditors there presented . . ."

The Referee based his disregard of the majority of creditors' claims on an insinuation of solicitation allegedly proved by certain letters "turned over" to him and on the so-called limitation in such letters of the powers of attorney in the proofs of claims to the election of a tentative trustee in the Chapter XI proceeding.

The Court of Appeals properly held that such letters, not appearing in the record of the meeting of creditors, could not be received "in a non-judicial manner" and could not be relied upon by the Referee (App. of Petition, p. 43). *In re Augenbaugh,* 125 F. 2d 887 (CCA 3rd, 1942). Petitioner has cited no decision in conflict with this holding.

Petitioner relies upon *In re N. S. Dalsimer & Co., Inc.,* 56 F. 2d 644 (S. D. N. Y., 1932), in which the District Court stated that (p. 647) it "cannot shut its eyes to what is general knowledge or to what it has ascertained by adequate inquiry." Putting aside the questionable validity of the quoted language, it is apparent from the opinion that the District Court was referring to its reliance upon general information in determining matters of general practice and policy as, for example, the general proposition that it is improper for a candidate for trustee to solicit proofs of claim. This is far different from the practice denounced by the Court of Appeals here, namely, that the Referee ". . . obtained (the letters he based findings on) in a non-judicial manner."

Even if the letters had been turned over to the Referee at the meeting rather than in camera, respondents were

entitled to a hearing on the issues of solicitation and of the validity of the powers of attorney. This is the crux of the decision of the Court of Appeals (App. of Petition, p. 44). It was incumbent upon those opposing the nominee of respondents to prove by proper evidence that the claims voted for him were not qualified. The record is barren of such proof.

The Court of Appeals went on to hold in accordance with prevailing law (App. of Petition, p. 44):

> ". . . We say this because even assuming, contrary to our belief, that the Referee had a proper record basis for his decision, we think that he was not justified in usurping the important right of creditors to appoint the Trustee. Indeed, this right is so important that absent a clear showing of material or prejudicial delay, the hearing to vote on such appointment should, if necessary, have been continued to give the creditors a reasonable opportunity to make their own choice. Compare In re Harris Const. Co., 37 F. 2d 951 (D. C. W. D. Pa., 1929)."

It is true that the question of postponement is largely within the discretion of the Referee because an election should be conducted as promptly as possible. But, where no hearing has been held *at all* on disputed matters relating to the election of a trustee, it is an abuse of discretion to refuse to postpone the election. *2 Collier on Bankruptcy*, 14th ed., p. 1647. Petitioner cites no decision contrary to these principles.

The many decisions included in the petition in support of the well known rule that an appellate court should not disturb the proper exercise of a lower court's discretion or findings of fact not clearly erroneous, in no way conflict with the conclusions reached by the Court of Appeals in this proceeding. They are simply inapplicable. *Lines v. Falstaff*, 233 F. 2d 927 (CCA 9th, 1956) and *Sloan Furrier v. Bradley*, 146 F. 2d 757 (CCA 6th, 1945) typify the inapropos citations the petitioner invokes.

Finally, in reliance upon *Manhattan Shirt Co. v. Tomlinson*, 327 F. 2d 449 (CCA 9th, 1964), petitioner contends that the Court of Appeals should have affirmed the appointment of the trustee on the ground that the assets had been liquidated and nothing remained to be done.

Mootness, strictly as a legal question, is not here involved. The issue of who should be the trustee is still viable. Liquidation is not the beginning and end of bankruptcy administration. An investigation of the acts, conduct and transactions of the bankrupt is basic, and it remains to be completed in this case. The recovery of preferences and voidable transfers, if any, and the examination of claims are other examples of important duties still to be performed by the trustee.

As a practical matter, the argument of petitioner would preclude a review in every case of a disputed election of a trustee. The time normally required in an appeal would always permit the appointed trustee to liquidate the assets before the validity of his appointment could be reviewed. The Court of Appeals wisely said (App. of Petition, p. 46):

> ". . . However, we think that the circumstances of this case dictate a reversal. We so conclude primarily because anything less would countenance what appears to have been a substantial violation of the creditors' right to appoint a Trustee. Moreover, the appellants and those associated with them before the Referee represented more than 95% in amount of the unsecured claims. Thus, the creditors who were disenfranchised will perhaps be entitled to the great bulk of any distribution to be made. It follows that they will be the ones substantially prejudiced by the delay in distribution and additional expenses which may have to be incurred. Under these circumstances and since the appellants seek a reversal, we think the economic and time factors are not of primary significance."

In the *Tomlinson* case, the Referee in fact held an election, and all parties were permitted to be heard although certain claims were denied the right to vote. On appeal, in dealing with such denial, the Court found that the record was incomplete, and that it was not possible to say whether improper solicitation had occurred, as claimed. From the record on appeal, the Court could not conclude that the Referee had abused his discretion. As an additional reason, the Court felt that no good purpose would be accomplished by reversing the election after the assets had been liquidated and 17 months had elapsed. It is to be noted that in *Tomlinson,* a creditors' committee was appointed and participated in the proceedings. The Court concluded that even if the procedure whereby the trustee was elected was not entirely proper, no substantial rights were affected.

Tomlinson does not represent a conflict with the present decision. The Court in *Tomlinson* as a matter of appellate discretion refused to disturb the action of the lower court because no useful purpose would have been served and no substantial rights were affected. Here the Court of Appeals has found a denial of due process in the lack of a hearing and substantial prejudice to the rights of the major creditors. Even if the issue should be regarded as an exercise of appellate discretion, the opinion of the instant court can hardly be characterized as arbitrary.

It is respectfully submitted that this proceeding involves no conflict of decisions on any question of law.

III. There Is No Important Question of Federal Law.

The primary issue is the supervisory power of the court of bankruptcy over the election of a trustee and the extent of appellate review permissible. The discussion above establishes that there is no unsettled question of law involved nor any conflict among the circuits with respect to legal principles. The decisions on this subject are con-

cerned largely with the amount of discretion allowed to the lower court initially and to the appellate court in its review. The present case turns on the application of settled principles to particular facts. Whatever the final outcome, no important question of federal law will be decided.

The order of the Court of Appeals is, in effect, a direction to the Referee to hold another hearing and an election of a trustee. In one sense, the decision is not a final disposition. It represents merely a determination of a procedural point in bankruptcy administration. The final election is yet to come.

This is not to say that the election of a trustee in bankruptcy is unimportant. It is a vital cog in bankruptcy administration. But, the discussion above has already fully demonstrated that no critical question of law which is unresolved is pertinent to the decision of this case.

IV. The Decision Below Is Clearly Correct.

Here again the preceding discussion has covered the ground. The excellent opinion of the Court of Appeals so well supports its decision that to rephrase it would be supererogation.

Respondents are the major creditors. They have been deprived of the opportunity to elect a trustee of their own choosing as provided in the Bankruptcy Act. If there was a substantial issue with respect to the qualification of certain claims to vote, a hearing should have been held. To deny creditors this right to vote without a hearing is a denial of due process. This is the heart of the case, and this is what the Court of Appeals decided. The respondents are entitled to a hearing on their right to vote and cannot be disfranchised by the Referee's reliance on a secret dossier. The law cannot be otherwise.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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Dated: June 28, 1967.